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SUBJECT: 2008 BUDGET FORECASTS ANOTHER LARGE INCREASE IN
SPENDING

REF: (A) BAKU 737 (B) BAKU 1124

Classified By: Pol/Econ Chief Joan Polaschik, per reasons 1.4 (b,d).

¶1. (SBU) The Cabinet of Ministers approved the 2008 state budget on September 25 and sent it to the President's office for approval and final submission to Parliament. Exact details regarding the composition of the budget have not yet been disclosed publicly. According to initial press reports, the 2008 state budget will total USD 18.75 billion, with revenue of USD 8.71 billion (an increase of 28 percent) and expenditures of USD 10.04 billion (an increase of 35 percent). Overall, the 2008 state budget increased by 35 percent compared to the 2007 state budget. the consolidated state budget (state budget, Social Protection Fund budget and state Oil Fund budget) revenues and expenditures will reportedly total more than USD 24 billion. The State Oil Fund will reportedly transfer USD 1.3 billion to the budget, an increase of 97 percent compared to 2007.

¶2. (SBU) Press reports indicate that targeted social spending will increase by more than 20 percent over the 2007 budget and will total USD 3.28 billion. Additional press reports indicated that military spending also increased by approximately 25 percent compared to the final 2007 budget. Capital investment will also reportedly increase by 48 percent.

¶3. (SBU) The final 2007 state budget revenues and expenditures totaled approximately USD 14 billion, with revenues totaling more than USD 6 billion and expenditures more than USD 7 billion. In its May 2007 supplemental budget, the GOAJ increased expenditures by almost USD 700 million or 10 percent. For 2006, government budget revenues totaled USD 5.65 billion, an increase of 54 percent from ¶2005. 2006 budget expenditures were USD 5.5 billion, an increase of 68.3 percent (REFTEL A).

¶4. (SBU) On September 27, Minister of Economic Development Heydar Babayev told reporters that the Ministry submitted to the Cabinet of Ministers a complex program of anti-inflation measures for 2008. Babayev stated that the GOAJ forecasted an increase in consumer prices of 12 percent for 2008. In a separate press briefing, Finance Minister Sharifov said that the GOAJ expects a five percent appreciation of the Azerbaijani manat versus the U.S. dollar in 2008.

¶5. (C) IFI reaction to the initial budget details has been mixed, especially since many had expected the budget not to increase dramatically based on the conclusions from the recent IMF visit to Baku (REFTEL B). While most representatives had been cautiously optimistic that the GOAJ would not increase spending drastically in order to preserve economic and political stability, IFI representatives believe

the 2008 budget indicates that the GOAJ will continue its expansionary fiscal policy. The local IFC representative called the proposed 2008 state budget "scary" and thought that it could increase still more as the parliament begins its budget debate. The local UNDP representative told EconOff that with presidential elections scheduled for 2008, it was not surprising the GOAJ increased budgetary spending.

¶6. (C) COMMENT: While the final details regarding the 2007 state budget are not yet known, it would appear that the GOAJ has not slowed its spending despite numerous calls from the international community and IFIs, including the IMF, to restrain fiscal spending. The increase in the proposed 2008 state budget, if approved in its current form, would initially represent a smaller increase than previous years, but with the already large amount of spending predicted, its macroeconomic effects will be long lasting. Although the Minister of Finance has repeatedly expressed concerns about inflationary pressures, the 2008 budget indicates that he has been unable to rein in fully government spending pressures. Azerbaijan's oil revenues are expected to increase significantly in 2008, making the case to save more difficult for the Minister of Finance and other reform-minded ministers.
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